

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
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Federal-State Joint Board on)
Universal Service)
_____)

CC Docket No. 96-45

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**COMMENTS OF PACIFIC TELECOM, INC.
IN RESPONSE TO QUESTIONS RELATING TO PROXY COST MODELS**

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SUMMARY

Pacific Telecom, Inc. ("PTI"), which operates rural telephone companies, believes that the questions that the Common Carrier Bureau posed in its December 12, 1996 Public Notice regarding the various proxy models for calculating universal service support warrant specific focus on the rural context. As the Federal-State Joint Board on Universal Service ("Joint Board") correctly found in recommending the application of proxies to calculate universal service funding, rural service raises unique concerns. The Joint Board's recommendations contemplate that (i) some form of cost model(s) ultimately would apply to rural carriers; (ii) the application of any cost model to rural carriers should be subject to a Commission finding of appropriateness based on the experience of non-rural LECs over a three year period; (iii) the Commission should base the rural cost model on the non-rural proxy model; and (iv) the Commission should adjust that non-rural model to take into consideration the special needs of rural carriers.

In view of the Joint Board's recommendations, PTI urges the Commission to appoint a separate panel as part of the forthcoming workshops on proxy cost models, to work with the federal and state commission staffs specifically on rural issues. Such a panel could coordinate efforts with the panels of experts participating in the workshops to develop a model that is based on the model(s) that the Commission ultimately adopts for non-rural LECs, but that also is tailored to reflect the special characteristics of rural markets, rural carriers, and rural consumers. Further, following the implementation of model-based support for non-rural LECs on January 1, 1998, the rural panel could continue to modify the derivative rural cost model as the experience of non-rural LECs warrants. In this way, the Commission and the state commissions will have a sound foundation upon which to make the determination that a particular model is appropriate in the rural context. Moreover, implementation of a separate rural panel in this proceeding could facilitate the subsequent resolution of issues in the Commission's pending Access Charge Reform proceeding.

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IN RESPONSE TO QUESTIONS RELATING TO PROXY COST MODELS**

Pacific Telecom, Inc. ("PTI") submits these comments in response to the Commission's December 12, 1996 request for comments on the questions that the Common Carrier Bureau posed to the proponents of various proxy models for calculating the cost of providing the services to be supported through the new universal service support mechanism.¹ PTI believes that in order to address such questions for rural telephone companies, it is essential to examine how the various proxy models perform in that context. As discussed more fully below, consistent with the recommendations of the Federal-State Joint Board on Universal Service ("Joint Board"), PTI urges the Commission to establish a panel of experts specifically to address rural carrier needs in the context of developing a comprehensive cost model for use in universal service funding.

¹ See Federal-State Joint Board on Universal Service: Staff To Hold Workshops on Proxy Cost Models on January 14-15, 1997, Public Notice, DA 96-2091, CC Docket 96-45 (released Dec. 12, 1996).

INTRODUCTION

Through its subsidiaries, PTI has a long and successful history of using universal service support to help provide local exchange services to small town and rural subscribers throughout Alaska, the Midwest and the Pacific Northwest,² and to expand service aggressively into otherwise unserved or underserved remote areas of the country. PTI's approximately 530,000 access lines are located predominantly in rural areas of the country where characteristics such as rugged terrain and low population density make the extension and maintenance of access lines very costly. PTI has participated actively in the Commission's universal service dockets for many years, and it is vitally interested in the current proceeding to implement the universal service provisions of the Telecommunications Act of 1996 ("1996 Act").

In its current proceeding, the Commission is examining the use of several proxy models for calculating the costs of providing services supported by the new universal service mechanism. As the Joint Board properly recognized in recommending the use of proxy models, however, the application of proxies to rural areas raises difficult questions that to date have not been addressed.³ PTI believes that it is imperative that those issues be evaluated fully before the Commission can determine whether any of the proxy models can be applied fairly to rural carriers.

² PTI provides local exchange service in predominantly rural areas in Alaska, California, Colorado, Idaho, Iowa, Minnesota, Montana, Nevada, Oregon, Washington, Wisconsin and Wyoming.

³ See, e.g., Federal-State Joint Board on Universal Service, Recommended Decision, FCC 96J-3, CC Docket No. 96-45, at ¶¶ 283, 285 (released Nov. 8, 1996) ("Recommended Decision").

Moreover, universal service is not the only area in which issues concerning the application of forward-looking costs arise. In its recently released Notice of Proposed Rulemaking concerning access charge reform,⁴ the Commission discussed at several places the relationships between various aspects of access charge reform and this proceeding concerning universal service.⁵ More specifically, in describing a possible prescriptive approach to access charge reform, the Commission noted the relationship between economically efficient pricing levels and the use of forward-looking costs, indicating that “Commission staff will soon be releasing for comment an analysis of the use of computer models in estimating forward-looking economic costs.”⁶ Although rural telephone companies are not immediately affected by the Access Charge Reform proceeding,⁷ both the use of forward-looking costs and the unique circumstances of rural telephone companies are common to both that proceeding and this one. Thus, implementation of a separate rural panel in this proceeding could facilitate the subsequent resolution of issues in the Access Charge Reform proceeding, as well.

I. A PANEL OF RURAL EXPERTS IS NECESSARY TO ASSURE ADEQUATE UNIVERSAL SERVICE SUPPORT FOR RURAL AREAS.

In recommending the use of proxy models, the Joint Board urged the Commission “to conduct a series of workshops at which federal and state staff can work with industry

⁴ See Access Charge Reform, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488, CC Docket No. 96-262 (released Dec. 24, 1996) (“Access Charge Reform Notice”).

⁵ See, e.g., id. at ¶¶ 36-40, 98, 155, 314.

⁶ Id. at ¶ 222.

⁷ Id. at ¶¶ 50-53. All incumbent LECs, however, are subject to rules being addressed in Sections III.D, III.E, and VII.A of the Access Charge Reform Notice. See id. at ¶ 53.

participants to refine the models so that it could become possible to select or create a proxy model that could then be used in calculating universal service support.”⁸ Based on this recommendation, the Common Carrier Bureau has issued a Public Notice scheduling workshops to discuss issues relating to the use of proxy cost models to calculate universal service support.⁹ But the Public Notice does not specifically recognize the importance of according special attention to the application of a proxy model in the rural context. For the reasons discussed below, PTI believes that it would greatly serve the public interest to establish a separate panel of industry experts to focus on ways to tailor any cost model that ultimately is selected to the needs of rural service providers. The panel could begin discussions immediately in conjunction with the workshops planned for January 14-15, 1997, and continue until the implementation of one or more proxy models for rural telephone providers.

The establishment of a panel of rural service experts would be fully consistent with the Joint Board’s findings and recommendations in its Recommended Decision. While the Joint Board concluded that “using cost estimates generated by proxy models is a reasonable technique for determining forward-looking costs,”¹⁰ the Joint Board also clearly was concerned about the application of proxies to rural carriers. As the Joint Board explained:

While we recommend using forward-looking economic costs calculated through the use of a proxy model to determine high cost

⁸ Recommended Decision at ¶ 281.

⁹ See Federal-State Joint Board on Universal Service: Staff To Hold Workshops on Proxy Cost Models on January 14-15, 1997, Public Notice, DA 96-2091, CC Docket No. 96-45 (released Dec. 12, 1996). Pursuant to the Public Notice, PTI has formally requested that Mr. Theodore Otis, an expert in the determination of the costs of providing universal service especially in rural areas, be permitted to participate in the workshops on its behalf.

¹⁰ Recommended Decision at ¶ 276.

support for all carriers, we are concerned that moving small, rural carriers to a proxy model too quickly may result in large changes in the support they receive. Since rural carriers generally serve fewer subscribers relative to the large incumbent LECs, serve more sparsely populated areas, and generally do not benefit from economies of scale and scope as much as non-rural carriers, they often cannot respond to changing operating circumstances as quickly as large carriers.¹¹

These conclusions about the unique characteristics of rural carriers are fully supported by the record evidence. PTI has submitted evidence to the Commission demonstrating, for example, that approximately 40% of PTI's exchanges serve less than 500 access lines, and that rural carriers cannot realize many of the cost economies associated with modern digital switching at such relatively low levels of demand aggregation.¹²

While the Joint Board nevertheless recommended that a cost model be applied to rural telephone companies following a three-year transition period, the Joint Board also emphasized that the Commission should tailor any cost model that it adopts to take into account "the unique situations of rural carriers" and to ensure congruency with the purposes of the 1996 Act.¹³ The Joint Board therefore specifically recommended that "[p]rior to that transition, . . . the Commission, working with the state commissions, [should] review the proxy model to ensure

¹¹ Id. at ¶ 283 (footnote omitted).

¹² See, e.g., Comments of Pacific Telecom, Inc., at 11 (filed Oct. 10, 1995), in Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286 (noting that PTI's average exchange serves less than 1700 access lines, with 40% serving less than 500 lines, and including a graphic comparing PTI's investment per line with the number of total lines being served).

¹³ Recommended Decision at ¶ 283. The Joint Board also recommended that the Commission define "rural carriers" as "those carriers that meet the statutory definition of a "rural telephone company" under the 1996 Act. Id. at ¶ 287 (citing 47 U.S.C. § 153(37)).

that it takes into consideration the unique situations of rural carriers.”¹⁴ The Joint Board’s cautious approach to rural carriers’ needs is reflected further in its recommendation that additional study of the proxy models’ application to rural carriers is needed during a transition period:

We find, however, that, because of the difficulty in precisely modelling small, rural carriers’ costs, they should continue to draw high cost support calculated based on an embedded cost methodology until we have more experience with the proxy models. . . . The Joint Board recommends that rural carriers should begin shifting to a proxy-based system three years after the implementation of a proxy-based methodology for non-rural LECs and the Commission, working with the state commissions, has reviewed the appropriateness of using a proxy model for rural carriers.¹⁵

Thus, the Joint Board contemplated that: (i) some form of cost model(s) ultimately would apply to rural carriers; (ii) the application of any such model to rural carriers should be subject to a Commission finding of appropriateness based on the experience of non-rural LECs over a three-year period; (iii) the Commission should base the rural cost model on the non-rural model; and (iv) the Commission should adjust that non-rural model to take into consideration the special needs of rural carriers.

In light of the structure that the Joint Board has recommended, PTI urges the Commission to appoint a separate panel as part of the forthcoming workshops on proxy cost models, to work with the federal and state commission staffs on rural issues. Such a panel could

¹⁴ Id. at ¶ 283. The Joint Board further recommended that “rural carriers transition to the proxy model adopted for calculating high cost support in areas served by non-rural incumbent LECs.” Id. at ¶ 285.

¹⁵ Id. at ¶ 285 (emphasis added).

coordinate efforts with the panels of experts participating in the workshops to develop a cost model that is based on the model(s) ultimately derived from the workshops and adopted by the Commission, but that also is tailored to reflect the needs and characteristics of rural markets, rural carriers, and rural consumers. Further, following the implementation of proxy model-based support for non-rural LECs on January 1, 1998, the rural panel could continue to modify the rural cost model as the experience of non-rural LECs warrants. In this way, the Commission and the state commissions ultimately will have a sound foundation upon which to make the determination that a particular cost model is appropriate for rural carriers for universal service purposes.

II. A PANEL OF RURAL EXPERTS WILL FACILITATE THE FUTURE RESOLUTION OF ACCESS CHARGE ISSUES APPLICABLE TO RURAL TELEPHONE COMPANIES.

In limiting the scope of its Access Charge Reform proceeding to incumbent LECs subject to price cap regulation, the Commission noted that price cap regulation currently circumscribes 91% of interstate access charge revenues and more than 92% of total incumbent LEC access lines.¹⁶ Further, the Commission asserted that the need for access charge reform is most immediate for those incumbent LECs that may soon be subject to competition and that rural telephone companies did not fit that particular bill:

For example, section 251(f)(1) exempts rural telephone companies from the requirements of section 251(c)(2) ["Interconnection"] until the rural telephone company has received a bona fide request

¹⁶ Access Charge Reform Notice at ¶ 51.

for interconnection, services, or network elements, and the state commission determines that the exemption should be terminated.¹⁷

Accordingly, rural telephone companies, being governed by rate-of-return regulation at present, are subject only to potential access charge modifications in limited matters.¹⁸

The determination of rural LEC forward-looking costs in this proceeding, however, is clearly relevant to the Access Charge Reform proceeding. First, the investment made by rural carriers is unitary in nature. Access charges and universal service funding are the two primary interstate sources of return upon and recovery of that investment. Discontinuities in cost models applicable to universal service and to access charge reform could severely impair the viability of rural telephone companies for the reasons accurately described by the Commission in this proceeding.¹⁹

Second, the Commission proposed that changes in universal service and access charge recovery might require adjustment to avoid over-collection of revenues.²⁰ The Commission requested of the parties in the Access Charge Reform proceeding an analysis of any instances in which incumbent LECs might be compensated twice for providing universal service, expressly referencing the “assumed structure of high-cost area support mechanisms.”²¹ With

¹⁷ Id. at ¶ 52 n.88.

¹⁸ The Commission further stated, “[w]e propose, however, limited exceptions to our decision to confine this proceeding to price cap incumbent LECs. Specifically, we propose to apply to all incumbent LECs the rules discussed in Section VII.A, which addresses allocation of universal service support to the interstate revenue requirement, and Sections III.D and E, which propose reforms to the transport rate structure, including the TIC.” Id. at ¶ 53.

¹⁹ Recommended Decision at ¶ 283.

²⁰ Access Charge Reform Notice at ¶ 244.

²¹ Id.

regard to rate-of-return incumbent LECs, particularly, the Commission observed that “interstate costs must be reduced to reflect revenues received from any new universal service support mechanism to the extent allocated to the interstate jurisdiction.”²²

But the source, nature, and amount of any such potential “double recovery” derives directly from the cost model being employed. Given the Commission’s acknowledgment in the Access Charge Reform Notice of the interrelationship between the determinations in that proceeding and in this proceeding, it would be both administratively efficient and conducive to the Commission’s public interest goals in both proceedings to focus here on rural telephone cost issues through the vehicle of a separate rural, expert panel.

CONCLUSION

Appointment of a separate panel to examine cost issues for rural telephone companies is essential to the efficient, effective, and fair resolution of both universal service and access charge issues already in play in several Commission proceedings. Congress, in the 1996 Act, recognized the unique characteristics and considerations attending rural service in America. This uniqueness also has been acknowledged by the Joint Board and the Commission. In order to effectively carry out legislative and regulatory policy for rural service, the determination of an accurate, relevant cost model, one that “takes into consideration the unique situations of rural carriers,” is essential. A panel of rural experts, working to coordinate these issues in this proceeding, would not hinder or impair the development and implementation of Commission policy for the bulk of the telecommunications industry, particularly as in both this proceeding

²² Id. at ¶ 246.

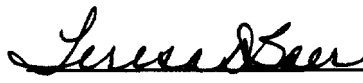
and that concerning access charges, rural issues already have been set aside for separate development and treatment. Conversely, establishment of such a panel would facilitate a more timely and efficacious resolution of the issues for rural areas than disparate proceedings are likely to yield.

For the foregoing reasons, PTI respectfully requests that the Commission appoint a separate panel of rural service experts to address rural carrier needs in the context of developing a comprehensive proxy model for use in universal service funding, and in such other areas as appears appropriate in the future, based on the evolution of parallel Commission proceedings. In support of this effort, PTI commits its corporate resources to any panel so formed and offers the services of its expert, Mr. Theodore Otis, as an active participant on that panel.

Respectfully submitted,

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January 7, 1997

CERTIFICATE OF SERVICE

I hereby certify that I have this 7th day of January, 1997, caused a copy of the foregoing "Comments of Pacific Telecom, Inc. in Response to Questions Relating to Proxy Cost Models" to be served by first class mail, postage prepaid, on the following:

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